Ontario Financing Authority

Annual Report 2005

Ontario

106-03419/

Mandate

The *Capital Investment Plan Act, 1993* (CIPA) established the Ontario Financing Authority (OFA) and sets out the objects and powers of the OFA. In this regard, the OFA:

- Conducts borrowing, investment and financial risk management for the Province of Ontario;
- Manages the Provincial debt;
- Provides financial and centralized cash management services for the Province;
- Advises ministries, Crown agencies and other public bodies on financial policies and projects;
- Assists Crown agencies and other public bodies to borrow and invest money; and
- Acts as an intermediary for the Province in lending to certain public bodies and invests on behalf of some public bodies.

The OFA also provides a broad range of financial services to the Ontario Electricity Financial Corporation (OEFC) and the Ontario Strategic Infrastructure Financing Authority (OSIFA).

The *Financial Administration Act* (FAA) sets out certain financial powers that the OFA exercises on behalf of the Province in order to carry out the Province's borrowing program, manage the Province's debt and invest its liquid reserves.

Annual Report 2005

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Statement from the Chair and the Chief Executive Officer

We are pleased to present the Ontario Financing Authority's 2005 Annual Report. The report outlines the Authority's responsibilities, accomplishments and financial results for the year April 1, 2004, to March 31, 2005, and includes objectives for the next year.

The OFA was able to achieve its primary goal of borrowing $24.8 billion for both the Province and the Ontario Electricity Financial Corporation (OEFC) at competitive terms and conditions in the long-term public markets. Total savings from borrowing, money market and debt management activities were $150.2 million.

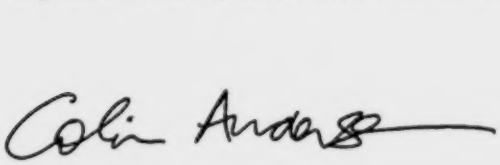
The OFA monitors the Province's Interest on Debt (IOD) to ensure that it is managed in a sound and efficient manner. Interim IOD costs were $720 million below the 2004 Ontario Budget projection due to lower-than-forecast interest rates and continued professional and cost-effective debt management.

The OFA contributed to key government initiatives in 2004–05 by providing financial advice to a number of public sector organizations. For example, the OFA led the development of the financial structure for the new Ontario Power Authority (OPA), established by the *Ontario Electricity Restructuring Act, 2004*. As well, the OFA provided advice to the Ontario Lottery and Gaming Corporation (OLGC) in arranging a five-year, $794 million loan for the construction of the new Casino Niagara. The OFA also assisted the University of Ontario Institute of Technology (UOIT) in obtaining its first bond financing, a $220 million unsecured bond issue.

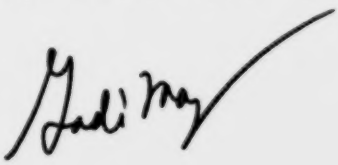
The OFA supported the creation of the Ontario Strategic Infrastructure Financing Authority (OSIFA), including issuing its first Infrastructure Renewal Bond (IRB) for $650 million.

The OFA has a number of challenging initiatives in fiscal 2005–06. Long-term public borrowing requirements are forecast at $27.2 billion. The OFA pre-funded $5.9 billion of its 2005–06 borrowing requirements before the fiscal year, taking advantage of favourable market conditions to lock in the lowest long-term interest rates since the early 1960s. The most significant component of the borrowing program will be the refinancing of maturing debt. Debt maturities for the Province and OEFC are estimated at $20.5 billion in 2005–06.

Other initiatives that will engage the OFA in 2005–06 include supporting the government on the financial aspects of electricity sector reforms as well as advising on a number of public sector financing initiatives.



Colin Andersen
Chair



Gadi Mayman
Chief Executive Officer and Vice-Chair (interim)

Management's Discussion and Analysis

Economy

Financial Markets

Borrowing and Debt Management

Treasury Management Services and Financial Reporting

Financial Advice and Assistance

Services to Agencies and Other Financial Initiatives

Management's Discussion and Analysis

This section details management's discussion and analysis of the OFA's results in 2004–05, including its objectives for 2005–06. The discussion begins with a review of the economy and financial markets in 2004.

Economy

As in 2003, the appreciation of the Canadian dollar was one of the most important economic events of the year. The Canadian dollar increased a further 8 percent in 2004 following the record 19 percent increase in 2003. In early 2005, the dollar eased from over 85 cents U.S. and traded more narrowly in the 80 cent range. Despite this drop, the rapid appreciation of the dollar over the past two years has created a significant challenge for Ontario exporters, lowering profit margins and in some cases reducing export volumes.

Rising energy prices, especially oil prices which surpassed U.S.$50 per barrel in 2004, also dampened economic growth in Ontario last year. While the currency appreciation mitigated some of the impact of higher energy prices, Ontario businesses and consumers had to devote a larger share of their budgets to energy costs.

The U.S.—Ontario's leading trade partner—grew by a strong 4.4 percent in 2004, the fastest pace since 1999. Economic growth was broadly based with both the household and business sectors contributing to the rise, providing healthy markets for Ontario exports.

Ontario's real GDP grew by 2.6 percent in 2004, below the 2.8 percent rate of growth for the national economy but up from the 1.6 percent rate of increase in 2003. Economic growth in Ontario was supported by solid consumer spending, up 3.2 percent for the second year in a row, strong business spending on machinery and equipment, which advanced 7.4 percent (the strongest increase in five years) and continued accumulation of business inventories. The strong growth of the Ontario housing market continued as residential investment grew by 4.2 percent, the sixth straight annual increase. Spending on residential construction reached an all-time high of $26.4 billion (1997 dollars).

Ontario exports, both international and interprovincial, rebounded by a strong 5.1 percent in 2004, after declining 0.6 percent in 2003. Ontario's imports, stimulated by the strong dollar and solid growth in domestic demand, grew by 7.0 percent, following a 3.8 percent gain in 2003. With imports continuing to outpace exports, net trade continued to be a significant drag on growth. Ontario's real trade surplus fell for the second consecutive year, narrowing to $43.6 billion (1997 dollars), its lowest annual level since 1998.

Financial Markets

The U.S. Federal Reserve began to raise short-term rates in June 2004, when the Federal Reserve Funds Rate target stood at 1.00 percent, to bring monetary policy to a more neutral stance. During the fiscal year, the U.S. Federal Funds rate increased seven times by 25 basis points, to 2.75 percent, reflecting strong economic activity in the U.S., rising energy prices and inflationary pressures.

The Bank of Canada lowered its interest rate once in April 2004, by 25 basis points, to 2.00 percent. Following the lead of the U.S. Federal Reserve, it subsequently raised interest rates twice by 25 basis points, once in September and again in October. Factors in the Bank's decision to raise its target for the overnight rate were the economy, which is expected to remain near its production capacity, and higher CPI, reflecting higher oil prices.

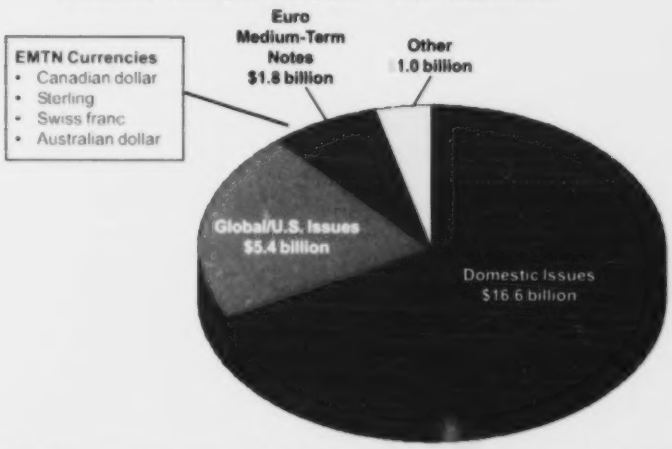
Yields on U.S.10-year notes rose in fiscal 2004, from 3.84 percent to 4.48 percent. The 10-year Canada yields began the fiscal year at 4.33 percent and rose, eventually peaking in mid-June at 5.04 percent. Yields then declined for the rest of the year to close at 4.31 percent. As a result, the spread between Canadian and U.S. bond yields narrowed throughout 2004, eventually becoming negative in early 2005. Negative spreads between Canada and the U.S. are expected to persist through 2005 as the Federal Reserve continues to increase interest rates while the Bank of Canada maintains rates.

In 2004–05, both the Bank of Canada rate and the 10-year Canada yields were trading well below their 50-year historical averages. Since the close of the fiscal year, bond yields have continued their downward trend, trading at their lowest levels since the late 1950s. The OFA was able to take advantage of lower rates to pre-fund part of the Province's 2005–06 long-term public borrowing requirement.

Borrowing and Debt Management

The primary goal of the OFA is to meet the Province's financial requirements in a prudent and cost-effective manner. To this end a number of initiatives with respect to borrowing, investment and debt management were completed in 2004–05.

C$24.8 billion issued – All Markets

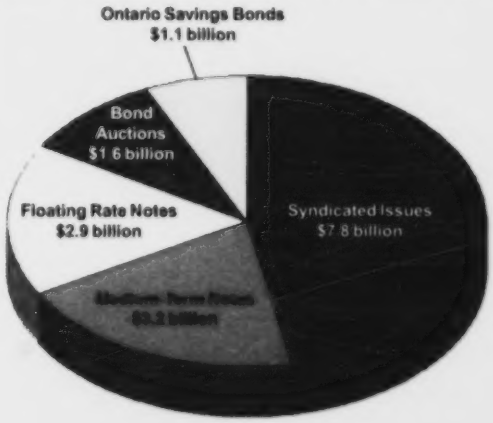


The OFA completed long-term public borrowing of $24.8 billion on behalf of the Province and OEFC, compared to the 2004 Ontario Budget forecast of $23.8 billion. The $24.8 billion included $5.9 billion in pre-funding for the 2005–06 requirement as the OFA took advantage of favourable market conditions. Without the pre-funding, the 2004–05 requirement would have been $4.9 billion lower than the $23.8 billion forecast in the 2004 Ontario Budget.

While the majority of borrowing was completed in the domestic market, the OFA further diversified the Province's funding sources by raising the equivalent of $7.2 billion in the international capital markets, achieving costs comparable to those in the Canadian domestic markets.
Highlights include:

- Four U.S. dollar global bonds;
- Euro Medium-Term Notes (EMTNs) in Canadian dollars, Australian dollars, Swiss francs as well as the first Sterling-denominated bond issued since 1998.

C$16.6 billion issued - Domestic Market


Ontario Savings Bonds $1.1 billion
Bond Auctions $1.6 billion
Floating Rate Notes $2.9 billion
Syndicated Issues $7.8 billion

In 2004–05, $16.6 billion, or almost 67 percent of the total long-term public borrowing requirements were completed cost-effectively in the Canadian domestic market through a variety of financing approaches aimed at meeting investor demand:

- $7.8 billion through bond issues broadly targeted to domestic investors;
- $3.2 billion in Medium-Term Notes (MTNs) with different terms and structures to meet specific investor preferences;
- $2.9 billion in Floating Rate Notes; and
- $1.6 billion through three bond auctions.

The OFA also raised $1.1 billion through the 2004 Ontario Savings Bond campaign, aimed at retail investors in the Province.

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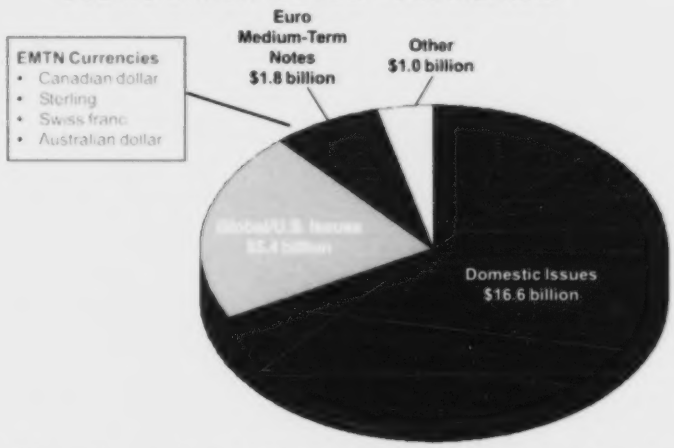

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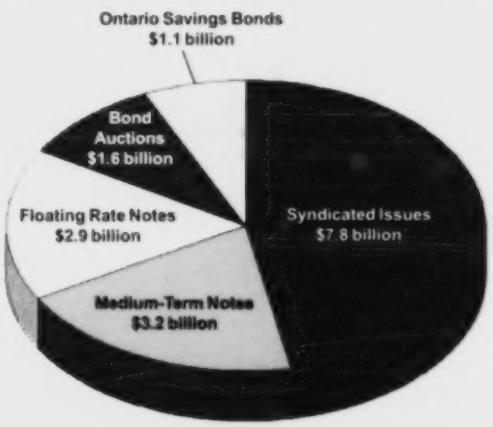
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Debt Management Activities and Policies

The OFA employs prudent risk management policies and practices to mitigate the financial risks inherent in a large and diversified debt portfolio.

A variety of financial instruments, such as options and swaps, are utilized to manage the Province's exposure to fluctuations in interest rates and foreign currency exchange rates. Risk exposures are monitored daily and audited annually. Risk management policies are reviewed annually and amendments are approved by the OFA Board of Directors.

The cost-effectiveness of borrowing and debt management activities is measured daily against established benchmarks.

Performance

The OFA measures and monitors the performance of the borrowing, debt management, and liquid reserve investment programs.

Note: Numbers may not add due to rounding.

Ontario's Total Debt of $156.6 billion is composed of bonds and debentures issued in both the short- and long-term capital markets and non-public debentures held by certain federal and provincial public sector pension plans and government agencies.

As at March 31, 2005, public debt totalled $131.3 billion, primarily consisting of bonds issued in the domestic and international long-term public markets in nine currencies. Ontario also had $25.4 billion outstanding in non-public debt issued in Canadian dollars.

Net Debt represents the difference between total liabilities and the total financial assets of the Province. Interim Net Debt was $142.2 billion as at March 31, 2005. Net Debt is projected at $146.0 billion as at March 31, 2006.

The performance of the borrowing program is measured through the difference between the "all-in" cost of the actual borrowing program against the all-in costs of hypothetical domestic borrowing of the same term and size implemented evenly over the fiscal year ("even-pace benchmark"). The cost difference is then compared with the performance of fixed income fund managers relative to a commonly used bond market index. During 2004–05, the cost of the borrowing program was $132.4 million lower than the even-pace benchmark, on a present value basis. This corresponds to first quartile performance relative to the peer group of fixed income fund managers.

The performance of the debt management program is evaluated based on a comparison of program savings with a risk budget. In 2004–05, the debt management program saved $10.2 million. This compares to a first quartile performance relative to the risk budget.

The performance of the short-term liquid reserve investments are measured relative to the returns of a custom benchmark with a term of 45 days. The performance difference is then compared with the performance of a peer group of money market managers. In 2004–05, the returns of the money market program were $7.6 million over the 45-day benchmark, which compares to a third quartile performance.

The OFA periodically reviews the methodologies used to measure the performance of the borrowing, debt management and liquid reserve investment programs. In 2004–05, the methodology employed to evaluate

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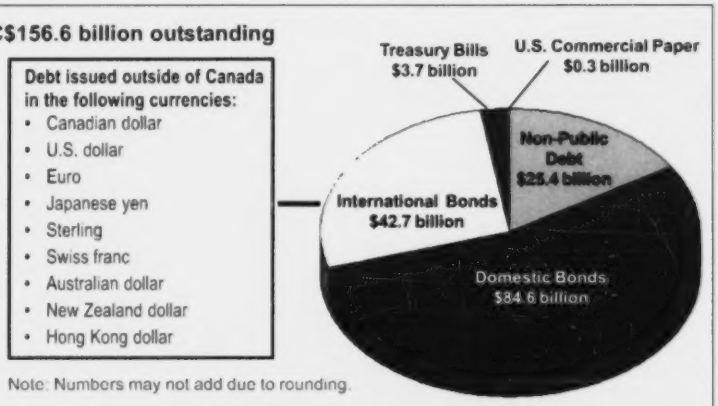

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The OFA periodically reviews the methodologies used to measure the performance of the borrowing, debt management and liquid reserve investment programs. In 2004–05, the methodology employed to evaluate

borrowing program performance was studied. Several European sovereign borrowers were identified through a review of government debt management studies undertaken by the International Monetary Fund (IMF) to gain insight into their approaches in measuring borrowing performance. The review indicated that while many governments issue debt, only a few measure the performance of their programs. Among issuers measuring performance, it is common to evaluate program success through even-pace benchmarks, a practice followed by the OFA. The review also found that some issuers use term benchmarks to evaluate program performance.

Market Risk

Market risk is the risk of loss due to changes in interest rates and foreign exchange.

The Province aims for a balanced debt maturity profile to mitigate the interest rate risk inherent in refinancing maturing debt and the interest rates on floating-rate debt. Interest rate exposure from maturing debt and floating rate debt was 10.2 percent of outstanding debt as at March 31, 2005. During the fiscal year, interest rate resetting exposure was within the Province's approved limit of 25 percent of outstanding debt. In 2004–05, maturities amounted to $15.3 billion. Estimated maturities for the next three years are $20.5 billion in 2005–06, $14.5 billion in 2006–07 and $14.4 billion in 2007-08.

Net foreign exchange exposure was 0.8 percent of outstanding debt as at March 31, 2005. During the fiscal year, foreign exchange exposure was consistently within the Province's approved limit of five percent of outstanding debt.

Credit Risk

Credit risk is the risk of loss due to default of bond issuers or counterparties of derivatives or other financial transactions.

The lowest acceptable credit rating of counterparties for Ontario is "A" minus. However, Ontario typically enters into new swap transactions with counterparties rated "AA minus" or higher. As at March 31, 2005, the Province's total swap portfolio had a notional value of $100.9 billion, which consisted of $30.9 billion in cross-currency swaps and $70.0 billion in interest rate swaps. At year-end, over 80 percent of the Province's counterparties with swaps outstanding had credit ratings "AA minus" or higher.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems, or external events.

The OFA manages operational risks through divisional procedures, contingency plans as well as appropriate staffing and training, all of which are reviewed on an ongoing basis.

The reliability of information technology and computing systems is crucial to ensuring the OFA carries out its mandate efficiently and effectively. To this end, systems for the OFA, OEFC and OSIFA were maintained at a high level during 2004–05 to ensure availability, integrity and security.

Business Continuity Planning

As part of its risk management strategy, the OFA has a Business Continuity Plan (BCP) based on a decentralized recovery model. The plan ensures that critical operations are completed in a timely manner in the event of a business disruption. BCP advisors and recovery team leaders maintain contact with Ministry of Finance and other BCP related committees and initiatives to ensure that the BCP is aligned with the other areas of the Ontario government. BCP tests and training sessions are conducted regularly. In 2004–05, staff attended BCP training and awareness presentations and a number of BCP-related tests were undertaken.

Liquidity Risk

Liquidity risk is the risk that liquid reserves are not sufficient to meet cash requirements.

This risk is controlled through the management of operational cash flows, liquid reserves levels and short-term borrowing programs. The average level of liquid reserves was $8.4 billion in 2004–05. The Province's Treasury Bill and U.S. Commercial Paper programs have authorized limits of $12.0 billion ($6.0 billion for the Province and $6.0 billion for OEFC) and $2.5 billion, respectively.

Credit Rating Agency Relations

The Province requires ratings from recognized credit rating agencies to issue debt at favourable conditions in public capital markets. To ensure the credit rating agencies are well informed on the Province's economic strength and financial position, the OFA has ongoing discussions to keep them apprised of the government's priorities and initiatives, including the Ontario Budget, and to ensure that these are accurately reflected in the agencies' ratings and reports on the Province. In addition, through the OFA, the government maintains a one-window contact with the agencies to ensure all information requests pertaining to government policies and or other information is consistent and coordinated.

In 2004, Moody's and Standard & Poor's confirmed the Province's Aa2 rating with a stable trend. Dominion Bond Rating Service (DBRS) also confirmed the Province's AA rating, but placed it on a negative trend. DBRS returned the trend to stable following its favourable review after the 2005 Ontario Budget.

Interest on Debt

The OFA monitors the Province's Interest on Debt (IOD) to ensure that it is managed in a sound and efficient manner. IOD costs were $720 million below the forecast in the 2004 Ontario Budget due to lower-than-forecast interest rates and continued professional and cost-effective debt management.

In 2004–05, several analytical tools used to forecast and analyze IOD were enhanced for the purpose of improving the accuracy of the IOD forecast.

Objectives for 2005–06

Long-term public borrowing requirements for 2005–06 are forecast at $27.2 billion, a $2.4 billion increase from 2004–05. This amount includes $21.2 billion of debt maturities and debt redemptions, $19.0 billion for the Province and $2.2 billion for OEFC. As at March 31, 2005, the Province has pre-funded $5.9 billion of its 2005–06 borrowing program, leaving $21.3 billion remaining to be borrowed for the fiscal year.

The Canadian dollar domestic market will again be the main source of funding for the Province. The OFA will continue to diversify its domestic borrowing program by using a combination of syndicated issues, bond auctions, floating rate notes and medium-term notes. The 2005–06 borrowing program will include OSBs, with the size of the campaign to be determined by market conditions. The OFA also is reviewing the merits of issuing a Real Return Bond linked to the Canadian Consumer Price Index.

International markets will remain a significant component of the Province's borrowing program. While the U.S. dollar market is expected to be the most important international market, the OFA will also look at opportunities to expand its presence in the Euro market and increase issuance in Swiss francs, sterling and yen.

The OFA is completing documentation to permit the Province to issue debt in the Australian dollar domestic market. It also will explore opportunities to potentially access emerging markets such as Mexican peso and Turkish lira. Borrowing in these currencies will be converted into Canadian dollars.

The OFA will monitor and assess trends in government debt management and their implications for performance benchmarking to ensure that the OFA's benchmarks reflect best practices. Risk management policies will be

reviewed and revised as required in response to an ever-evolving regulatory and capital markets environment. The OFA will comply with risk management policies and portfolio program limits approved by the Board of Directors of the OFA and OEFC. Also in 2005–06, the OFA will advise on risk management policies to OSIFA and the OPA as required. Credit rating agencies will receive ongoing updates to ensure that the Province's ratings are based on current and timely information.

Finally, information technology application systems, security and project management services will be successfully delivered. This includes continuing to provide high availability, integrity and strong security throughout the OFA's technology infrastructure and systems.

Treasury Management Services and Financial Reporting

The OFA provided cost-effective cash management, settlement and banking services to the Province in 2004–05, supporting the maximization of returns on the Province's liquid reserves and effective debt management. The OFA also continued to provide accurate and timely financial reporting, undertook to strengthen operational and reporting controls and improved financial administration and support services provided to the borrowing and investment activities of other government programs and Crown agencies.

Cash Management

The 2004 Ontario Budget committed to improving the efficiency of the government's cash resources by implementing more standardized cash management practices across ministries and applicable agencies. The OFA met this commitment by obtaining ministerial approval for its cash management directive in August 2004. To support its implementation, OFA staff delivered a number of presentations and information sessions on the directive to ministries and agencies. Implementation of the directive will ensure that ministries and central agencies follow good cash management practices that are standardized across the government.

The OFA contributed to the government's new Integrated Financial Information System (IFIS) in 2004–05 through the development and implementation of a new streamlined cash forecasting process for the system. In developing this new process, the OFA worked closely with ministries and agencies to include stakeholder requirements to ensure that the new approach reduces fluctuations in cash holdings and duplication of information, minimizing Interest on Debt expenditures.

The OFA also implemented web-based real time platforms with most of the major Canadian banks in 2004, minimizing the potential for errors and improving the efficiency of cash management.

Accounting and Settlements

Improvements to the servicing of all capital market transactions and Interest on Debt for the Province, OEFC and OSIFA continued throughout fiscal 2004–05. Policies and procedures were updated on an ongoing basis to ensure that appropriate internal controls were improved. Conversion to a new wire payment system was successfully completed in March 2005. The new system improves controls in the Province's wire payments, making these more secure.

Throughout the year, accounting policies were kept current by monitoring pronouncements from the Public Sector Accounting Board (PSAB) and the Canadian Institute of Chartered Accountants (CICA), resulting in high quality financial reports for both the OFA and OEFC.

Banking Services

A competitive tender for the banking services was secured for the Ministry of Community and Social Services, Family Responsibility Office (FRO). The OFA awarded a five-year contract to the Royal Bank for the FRO banking services.

To improve the use of banking services across the government, best practices guidelines for electronic banking payments and bank reconciliation methods were produced and distributed to ministries.

Objectives for 2005–06

Cash Management

Cash management of the Province's non-tax revenues will be strengthened to ensure that these meet the requirements outlined in the cash management directive.

The OFA will work with Ontario Shared Services and the Ministry of Finance on a 2005 Ontario Budget initiative to develop standardized early payment discounts for vendors to improve savings to the Province.

Efforts will be made to ensure that the cash management impact to the Province is minimized as a result of the proposed transfer of the Province's corporate tax collection function to the Canada Revenue Agency (CRA).

Integration of the internal OFA cash management systems will be completed in 2005–06, reducing the potential for errors and maximizing the efficiency of cash management. In its continued pursuit of efficiencies, the OFA will consider methods to further leverage the web-based real-time access established with the major banks.

Accounting and Settlements

Accounting developments, including the alignment of Canadian accounting and international standards, will continue to be monitored to ensure that the OFA remains current with accounting pronouncements that could potentially affect the Province and OEFC's programs. Operational and reporting risk exposures will continue to be identified, assessed and mitigated on an integrated basis.

In addition, enhancements to the timeliness and accuracy of reporting will be made to meet the Ministry of Finance's financial and management reporting requirements.

Banking Services

A tender will be issued to obtain service providers to enable the ministries to continue accepting customers' credit and debit cards as payment mechanisms when purchasing government services. If this tender results in a change in service providers, the OFA will oversee the transition of the business.

With other stakeholders in the Ontario government and the financial industry, the OFA will develop a plan to modernize the government's payment processes and improve services to benefit recipients by replacing cheques with electronic payment mechanisms such as electronic fund transfers or new banking technologies that become available.

Also in 2005–06, the OFA, together with other government stakeholders, will implement *Interac Online*, an Internet payment mechanism. This will facilitate the online purchasing of services.

As well, a new cheque imaging process will be introduced as part of a Canada-wide initiative led by the Canadian Payments Association (CPA) to move financial institutions to digital imaging for processing cheques. This will result in improved cheque processing timelines, as well as operating efficiencies for bank customers such as the Province.

Financial Advice and Assistance

The OFA was active in 2004–05 in providing financial advice and assistance to ministries, Crown agencies and other public bodies on corporate and electricity finance policies and initiatives.

Financial Transactions

The OFA assisted the University of Ontario Institute of Technology (UOIT) in obtaining its first bond financing, a $220 million unsecured bond issue. To support the transaction, the OFA advised on the UOIT business case, reviewed bond offering documentation and attended presentations with the credit rating agencies. The bond issue received investment grade credit ratings of A2 from Moody's and BBB (high) from Dominion Bond Rating Service.

By providing advice in negotiations with lenders in 2004, the OFA continued to assist the Royal Ontario Museum (ROM) with financing for phase two of the Renaissance ROM Project.

Other transactions supported by the OFA include:

- The Ontario Lottery and Gaming Corporation's (OLGC) five-year $794 million loan. This resulted in permanent financing for the construction of the new Casino Niagara at the Province's five-year cost of borrowing plus 25 basis points;
- The Ontario Science Centre (OSC) and Ministry of Culture by reviewing and analyzing the OSC business case for the amended "Agent of Change" project. The division prepared the analysis for a nine-year $10 million loan by the OFA to the OSC to bridge finance the project; and
- The Niagara Parks Commission in its evaluation of Request for Proposals (RFP) to select financial institutions for a $5 million loan and $15 million line of credit.

Corporate Finance Projects

Also in 2004–05, the OFA provided advice to ministries on a variety of policies and projects, including effective leasing policies and structures, asset management, value for money benchmarks, and interest rate evaluations. Examples of the OFA's contributions include:

- Assisting with the development of the Infrastructure, Planning, Financing and Procurement framework released by the Ministry of Public Infrastructure Renewal (MPIR) in July 2004;
- Providing advice to the Ministry of Education in its review of its school renewals funding formula;
- Supporting MPIR and the Ministry of the Attorney General (MAG) in their review of the Durham Consolidated Courthouse project; and
- Assisting the Ministry of Northern Development and Mines (MNDM) in the review of Ontario Northland Transportation Commission's (ONTC) capital structure and asset management plan.

Electricity Finance Projects

In 2004–05, the OFA provided financial policy advice and analysis on the electricity sector and the impact of various policies and initiatives on the OEFC, including the management of the non-utility generators (NUGs) contracts. The OFA supported the effective implementation of the Ontario Nuclear Funds Agreement (ONFA) and the government's electricity reform policies and initiatives. Other examples of the OFA's contributions included:

- Assisting the Ministry of Energy in successfully obtaining a provisional credit rating for the Ontario Power Authority (OPA) and in the development of financial systems to ensure that the OPA is operational in early 2005;
- Monitoring the financial performance of OPG and Hydro One and impact of OEFC;
- Providing advice on the implementation of the *Electricity Restructuring Act, 2004* and the associated financial regulations required to implement the new market;
- Developing the initial prices for OPG's nuclear and base load hydroelectric generation by working with the Ministry of Energy and retaining CIBC World Markets as financial advisors; and
- Supporting the government's electricity supply initiatives, including the RFP for renewable energy supply and clean energy supply.

Objectives for 2005–06

In 2005–06, the OFA will continue to fulfill its mandate in providing financial advice and assistance to provincial ministries, Crown agencies and other public bodies regarding corporate finance and electricity finance policies and initiatives.

Activities will include providing advice to provincial ministries and agencies on cost-effective leasing policies and structures, appropriate due diligence on financing aspects of asset management projects, comprehensive advice on structuring and completing financial transactions and accurate determination of value for money benchmarks and interest rate evaluations.

Sectors that will be the focus in 2005–06 are public infrastructure financing initiatives, including projects pertaining to hospitals, highways and courthouses, as well as pooled capital procurement for provincial and municipal transit infrastructure, school renewal funding formulae and asset reviews. Advice also will be provided to support the cost-effective borrowing from the capital markets. Ongoing timely and accurate financial advice will continue to be provided to support the Royal Ontario Museum and the Ontario Lottery and Gaming Corporation.

As well, the OFA will continue to provide financial analysis, modelling and related advice on electricity sector issues, including the government's electricity supply initiatives and OEFC cash flows and stranded debt. The OFA also will monitor and provide financial advice and analysis to the government on OPG and Hydro One business plans and financial performance.

Services to Agencies and Other Financial Initiatives

The OFA assists or acts as an intermediary to Crown agencies and other public bodies in regard to their lending, borrowing and investment management activities. In addition, the OFA also oversees the management of funds related to the Ontario Nuclear Funds Agreement (ONFA).

Ontario Electricity Financial Corporation (OEFC)

Ontario Electricity Financial Corporation (OEFC) is responsible for managing of the debt and other liabilities of the former Ontario Hydro and other activities as directed by the government. OEFC assumed approximately $38.1 billion in total debt and other liabilities from the former Ontario Hydro upon the restructuring of Ontario's electricity sector in April 1, 1999.

As the legal continuation of Ontario Hydro, OEFC is counterparty to 84 remaining long-term Power Purchase Agreements (PPAs) with non-utility generators (NUGs) that the former Ontario Hydro entered into in the late 1980s and early 1990s. On behalf of OEFC, the OFA negotiated four NUG contracts to facilitate their integration into the competitive electricity market and reduce above-market costs. This brings the total number of revised NUG contracts to 27.

The OFA also provided support to OEFC to ensure that the full cost of the PPAs with the NUGs would be fully recovered starting from January 1, 2005. The OFA also provided advice and financial analysis in the modelling to estimate the long-term cash flows and defeasance timing of OEFC's debt as part of the OEFC annual audit process.

In 2005–06, the OFA will continue to administer the NUG agreements on behalf of the OEFC as well as provide ongoing financial analysis services.

Ontario Power Authority (OPA)

The OPA was established in December 2004 under the *Electricity Restructuring Act, 2004*. Its role is to ensure an adequate long-term supply of electricity in Ontario. Its activities include power system planning, generation development, promotion of conservation and management of retail price stability.

During 2004–05, the OFA provided guidance in seeking an initial credit rating for the OPA and establishing its financial policies. In addition, the OFA provided a $500 million credit facility to the OPA to support its ongoing operations. The credit facility will expire on December 31, 2006. The OFA also entered into a two-year services agreement with the OPA to provide cash management, investment and accounting support and to administer the contracts recently entered into by the OPA. Finally, the OFA assisted the OPA in obtaining its initial credit ratings with Moody's and DBRS.

The OFA will continue to provide ongoing transitional support to the OPA in 2005–06 as it establishes its operations to carry out its mandate.

Ontario Strategic Infrastructure Financing Authority (OSIFA)

The OFA supported the Ontario Strategic Infrastructure Financing Authority (OSIFA), including providing advice on OSIFA's creation and transition from the former Ontario Municipal Economic Infrastructure Financing Authority, issuing a $650 million Infrastructure Renewal Bond on behalf of OSIFA and executing the investment for the hedging of the issue.

In 2005–06, the OFA will continue to provide OSIFA with financing and investment support, advice on risk management policies and support its information technology requirements.

Northern Ontario Grow Bonds Corporation

With the Ministry of Northern Development and Mines and the Northern Ontario Grow Bonds Corporation, the OFA established a pilot Northern Ontario Grow Bonds program designed to attract and retain new investment and jobs in Northern Ontario. Announced in the 2004 Ontario Budget, the proceeds from the sale of Northern Ontario Grow Bonds will be used to provide loans to new and growing businesses in northern communities.

Northern Ontario Grow Bonds were issued exclusively to residents of Northern Ontario and are fully guaranteed by the Province. The inaugural Northern Ontario Grow Bonds campaign raised approximately $13 million. In 2005–06, the OFA will continue to provide financial, investment advisory and banking services as required by the Northern Ontario Grow Bonds Corporation.

Investment Management Services

In 2004–05, the OFA provided investment management services to seven Ontario agencies, boards and commissions, including the Ontario Strategic Infrastructure Financing Authority, the Northern Ontario Heritage Fund Corporation and the Ontario Immigration Investor Corporation. The total funds managed for these organizations were $2.6 billion.

The OFA's investment fund initiative helps public bodies improve returns by improving investment processes and reducing investment costs. A new *Ontario Securities Act* regulation exemption gives the OFA the ability to create pooled funds without the need to register as an advisor or file a prospectus for each money market and bond fund created by the OFA.

Ontario Nuclear Funds Agreement (ONFA)

On behalf of the Province, the OFA, in conjunction with Ontario Power Generation Inc. (OPG), oversees the investment and management of two segregated funds established by the Ontario Nuclear Funds Agreement (ONFA).

These funds were established to pay for the future costs related to the decommissioning of nuclear stations and the disposal of used nuclear fuel. The OFA monitors the operations and reporting of the funds through liaison with OPG, the fund custodian and auditors. The OFA also is responsible for the development and implementation of the associated investment management policies.

As at March 31, 2005, the market value of the ONFA funds was $6.6 billion, compared to a market value of $4.9 billion when the funds began in July 2003. In 2004–05, there were 13 external investment managers retained to invest the nuclear funds in a combination of bonds and equities. The actual combined return of the funds was 7.6 percent, 2.2 percent higher than the long-term target of 3.25 percent real rate of return (3.25 percent plus Ontario CPI).

In 2004–05, the OFA continued to monitor budgets, disbursements and progress on nuclear waste management projects and programs. As well, fund disbursement reconciliations and audits were performed by the Internal Audit Services Branch of the Ministry of Finance to ensure OPG compliance of relevant ONFA provisions. Fund results were closely monitored and reported to the OFA Board on a regular basis throughout the fiscal year.

In 2005–06, fund investment policies and procedures will continue to be refined together with risk management requirements and reporting on the fund portfolios. As well, the OFA will continue to perform operational and related administrative functions as well as oversee the monitoring of nuclear funds operations and related reporting requirements.

Summary of Financial Results

The OFA manages the Province's debt and investments of liquid reserves and recovers its costs for these services. The OFA also provides treasury and administrative services to other Crown agencies and recovers its costs on a fee-for-service basis.

The OFA's income from operations for the year ended March 31, 2005, was $5,000 (March 31, 2004—$4,000). Net capital assets of the OFA as at March 31, 2005, were $2.2 million, representing a balance as at March 31, 2004, of $1.9 million, plus purchases of $1.4 million (mainly computer hardware) and less amortization of $1.1 million. Retained earnings of OFA of $136,000 (since inception) represent notional amounts. Annually, the OFA's financial results are consolidated on a line-by-line basis with those of the Province. This accounting treatment is in accordance with the Public Sector Accounting Board (PSAB) of the CICA, under which the OFA is considered a government organization.

As an intermediary for the Province, the OFA made loans to public bodies, the repayment of which is to be funded through third-party revenues. The outstanding balance of these loans, as at March 31, 2005, was $807 million, a net increase of $676 million (from the $131 million reported on March 31, 2004) as reported in Note 4(i) of the financial statements. The increase is mainly due to a loan made to the Ontario Lottery and Gaming Corporation of $794 million on June 30, 2004 (outstanding as at March 31, 2005—$685 million), to purchase the casino complex in Niagara Falls. Also, during the year, short-term loans totalling $76.6 million were issued to the Ontario Power Authority, of which the balance outstanding as at March 31, 2005, was $6.8 million. In addition, short-term loans, totalling $3.8 million, were issued to Ontario Northland Transportation Commission (ONTC) during October to December 2004 to refurbish commuter rail cars. ONTC credit facilities were restructured in March 2005 whereby ONTC was released of its obligation to repay $20.3 million under the credit facility of up to $27 million, which expired on March 31, 2005, and approval was received to extend ONTC's operating lines of credit until March 2008 for a maximum of $13 million. On January 31, 2005, a loan agreement also was made with the Centennial Centre of Science and Technology, whereby the Centennial Centre of Science and Technology was authorized to borrow up to $10 million by March 14, 2006. As at March 31, 2005, no amounts had been drawn.

The OFA continued to provide investment management services to other public bodies, such as Ontario Strategic Infrastructure Financing Authority, Northern Ontario Heritage Fund, Ontario Realty Corporation, etc. As at March 31, 2005, the OFA managed investments totalling $2,560 million (March 31, 2004—$1,794 million), on behalf of those entities as reported in Note 4(ii) of the financial statements.

The OFA also administers the loans receivable and payable of the former Ontario Municipal Improvement Corporation (OMIC). OMIC assets of $79 million consist of debentures receivable from various municipalities and school boards. An equal amount of liabilities are payable to Canada Pension Plan (CPP) and the Province. The majority of loan repayments will occur in the fiscal years ended March 31, 2012 and 2013. The interest earned and paid annually on account of OMIC assets and liabilities amounts to $7.6 million and is expected to remain at this level until CPP loans start maturing.

In the 2004 Ontario Budget, the Minister of Finance announced that the Government would be undertaking a review of major provincial assets to determine whether they are being managed effectively and efficiently. As at March 31, 2005, operating expenditures of approximately $370,000 were incurred—$830,000 less than the $1.2 million provided for in the Budget.

During the year, the OFA has been assisting the Ministry of Energy in the establishment of the Ontario Power Authority (OPA). The OPA is not a Crown agency, but rather a not-for-profit, non-share capital corporation. As of January 2005, the OFA started providing treasury, administrative and accounting services to the OPA.

The OFA staff continue to manage post-sale activities of the Province of Ontario Savings Office (POSO), including legal requirements and liaison with former POSO clients, to ensure that the needs of former POSO account holders are adequately met.

Financial Statements

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Responsibility for Financial Reporting

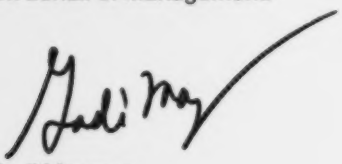
The accompanying financial statements of the Ontario Financing Authority have been prepared in accordance with accounting principles generally accepted in Canada and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to June 10, 2005.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit Committee of the Board of Directors.

The Board of Directors, through the Audit Committee, is responsible for overseeing that management fulfils its responsibilities for financial reporting and internal controls. The Audit Committee meets periodically with management, the internal auditors and the external auditor to deal with issues raised by them and to review the financial statements before recommending approval by the Board of Directors.

The financial statements have been audited by the Auditor General of Ontario. The Auditor General's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and opinion.

On behalf of Management:



Gadi Mayman
Chief Executive Officer and Vice-Chair (interim)
Ontario Financing Authority
June 10, 2005

Auditor's Report

Office of the Auditor General of Ontario

Bureau du vérificateur général de l'Ontario

Box 105, 15th Floor, 20 Dundas Street West, Toronto, Ontario M5G 2C2
B.P. 105, 15e étage, 20, rue Dundas ouest, Toronto (Ontario) M5G 2C2
(416) 327-2381 Fax: (416) 327-9862

Auditor's Report

To the Ontario Financing Authority
and to the Minister of Finance

I have audited the balance sheet of the Ontario Financing Authority as at March 31, 2005, and the statement of net income and retained earnings, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 2005 and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario
June 10, 2005

J.R. McCarter, CA
Auditor General

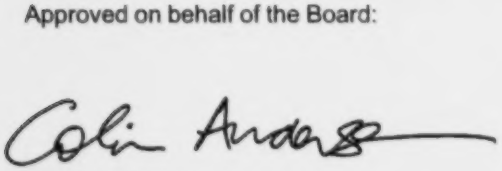
Balance Sheet

As at March 31, 2005

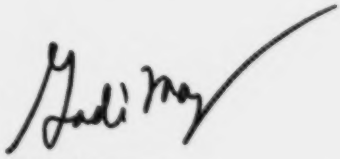
(in thousands of dollars)		**2005**		***2004***
ASSETS				
Current assets				
Cash	$	146	$	*141*
Accounts receivable		3,155		*2,852*
Due from agencies (note 4 (iii))		805		*1,140*
Loans receivable (note 2)		6		*6*
Total current assets	**$**	**4,112**	**$**	***4,139***
Long-term assets				
Capital assets (note 3)		2,225		*1,866*
Loans receivable (note 2)		79,021		*79,027*
Total assets	**$**	**85,358**	**$**	***85,032***
LIABILITIES AND RETAINED EARNINGS				
Current liabilities				
Accounts payable and accrued liabilities	$	5,380	$	*4,718*
Due to the Province of Ontario—Agencies		805		*1,140*
Due to the Province of Ontario—OMIC debt (note 2)		6		*6*
Total current liabilities	$	6,191	$	*5,864*
Long-term debt				
Due to CPP and the Province of Ontario (note 2)		79,031		*79,037*
Total liabilities	$	85,222	$	*84,901*
Retained earnings		136		*131*
Total liabilities and retained earnings	**$**	**85,358**	**$**	***85,032***

See accompanying notes to financial statements.

Approved on behalf of the Board:



Colin Andersen
Chair



Gadi Mayman
Chief Executive Officer and Vice-Chair (interim)

Statement of Net Income and Retained Earnings

For the year ended March 31

(in thousands of dollars)		**2005**		***2004***
REVENUE				
Interest	$	7,600	$	*7,600*
Cost recovery from the Province of Ontario (Note 4(ii))		14,970		*13,423*
Total revenue	**$**	**22,570**	**$**	***21,023***
EXPENSES				
Interest on long-term debt	$	7,595	$	*7,596*
Salaries, wages and benefits		10,900		*10,298*
Administrative and general		2,987		*2,338*
Amortization		1,083		*787*
Total expenses	**$**	**22,565**	**$**	***21,019***
Net income from operations for the year	$	5	$	*4*
Retained earnings, beginning of the year		131		*127*
Retained earnings, end of the year	$	136	$	*131*

See accompanying notes to financial statements.

Cash Flow Statement

For the year ended March 31

(in thousands of dollars)		**2005**		***2004***
Cash flows from operating activities				
Income from continuing operations	$	5	$	*4*
Adjustments to reconcile net income to funds provided by operating activities:				
Amortization		1,083		*787*
Net change in accounts receivable, payable and accrued liabilities		359		*892*
Cash flows from operating activities	$	1,447	$	*1,683*
Cash flows from financing activities				
Repayments to the Province re: OMIC loans	$	(6)	$	*(5)*
Repayments from holders of OMIC loans		6		*5*
Cash flows from/(used in) financing activities	$	—	$	—
Cash flows from investing activities				
Purchase of capital assets	$	(1,442)	$	*(1,678)*
Cash flows used in investing activities	$	(1,442)	$	*(1,678)*
Net increase in cash		5	$	*5*
Cash at beginning of the year		141		*136*
Cash at end of the year	**$**	**146**	**$**	***141***

See accompanying notes to financial statements.

Notes to Financial Statements

For the year ended March 31, 2005

BACKGROUND

The Ontario Financing Authority (the "OFA") was established as an agency of the Crown, on November 15, 1993, by the *Capital Investment Plan Act, 1993* (the "Act"). In accordance with the Act, the OFA's objects are:

- To assist public bodies and the Province of Ontario to borrow and invest money;
- To develop and carry out financing programs, issue securities, manage cash, currency and other financial risks on behalf of the Province or any public body;
- To provide such other financial services as are considered advantageous to the Province or any public body;
- Any additional objects as directed by the Lieutenant Governor in Council.

The OFA is a corporation established under the laws of Ontario. The OFA is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the *Income Tax Act of Canada*.

1. SIGNIFICANT ACCOUNTING POLICIES

(i) **General:** The financial statements are prepared in accordance with Canadian generally accepted accounting principles prescribed by the Canadian Institute of Chartered Accountants.

(ii) **Capital assets:** Capital assets are stated at cost. Amortization is provided using the straight-line method over the estimated useful life of the asset, as listed below, starting in the year of acquisition, i.e., half year depreciation is charged in the year of acquisition and half year in the year of disposal, irrespective of the date of acquisition or disposal.

Furniture and equipment	5 years
Computer hardware	3 years
Leasehold improvements	remaining life of lease

(iii) **Measurement uncertainty:** The preparation of the financial statements of the OFA requires management to make estimates and assumptions based on information available at the time of preparation of the financial statements and will be adjusted annually to reflect new information as it becomes available.

2. ONTARIO MUNICIPAL IMPROVEMENT CORPORATION (OMIC)

In accordance with the *Capital Investment Plan Act, 1993*, the Ontario Municipal Improvement Corporation's (OMIC) assets and liabilities were transferred to the OFA on November 15, 1993. OMIC received loans from the Canada Pension Plan (CPP) and the Province, which OMIC used to make loans to municipalities and school boards under similar terms as its debt.

As at March 31, 2005, the portion of long-term debt maturing in 2005–06 is $6,000 ($6,000 also matured in 2004–05) and is due to the Province. Long-term debt (maturing in the year ended March 31, 2007 and future) is comprised of debt due to the Province of $10,000 and to the Canada Pension Plan of $79 million (March 31, 2004 - $16,000, and $79 million respectively, maturing in the year ended March 31, 2006 and future).

The terms of the outstanding debt are as follows:
(*in thousands of dollars*)

Year ended March 31	As at March 31, 2005 Principal Maturing	Effective Average Interest Rate (%)	*As at March 31, 2004 Principal Maturing*	*Effective Average Interest Rate (%)*
2005	—		*6*	*11.25*
2006	6	11.25	*6*	*11.25*
2007–10	—		—	
1–5 years	$ 6		$ *12*	
6–10 years	79,031	9.61	*79,031*	*9.61*
Total	**$ 79,037**		***$ 79,043***	

3. CAPITAL ASSETS

The net book value (NBV) of capital assets is as follows:

(*in thousands of dollars*)

	Cost	Accumulated Amortization	NBV March 31, 2005	*NBV March 31, 2004*
Furniture and equipment	$ 362	$ 261	$ 101	$ *84*
Computer hardware	7,443	5,792	1,651	*1,395*
Leasehold improvements	1,068	595	473	*387*
Total	**$ 8,873**	**$ 6,648**	**$ 2,225**	***$ 1,866***

4. TRANSACTIONS WITH THE PROVINCE AND OTHER PUBLIC BODIES

(i) **Financing activities between the Province and other Public Bodies:** Acting as a financial conduit for the Province, the OFA provides financing to various public bodies, the repayment of which is expected from third-party revenues. The funds for these loans are advanced to the OFA by the Province under a credit facility of $2.16 billion. Repayments received from public bodies by the OFA are forwarded to the Province. These transactions are not reflected in these financial statements. In compliance with the Ontario Financing Authority Lending Policy adopted by its Board of Directors on December 17, 1997, each advance received by the OFA under the current facility bears interest at a rate that is equivalent to the rate of interest payable to the OFA on the corresponding loan to a public body(ies). As at March 31, 2005, $807 million (March 31, 2004—$131 million), including accrued interest, was advanced by the Province to the OFA and must be repaid by the OFA on or before August 31, 2027.

Funds generally are advanced by the OFA to public bodies under interim financing arrangements consisting of a number of promissory notes for terms not exceeding one year. Interest is payable on the principal outstanding. The promissory notes later are converted to term debt and repayment terms are finalized. As at March 31, 2005, the receivables represent debentures, except for the promissory note from the Centennial Centre of Science and Technology, line of credit to the Ontario

Northland Transportation Commission and short-term loans to the Ontario Power Authority.

The following represents amounts receivable by the OFA on behalf of the Province, including accrued interest. These are related party transactions, with the exception of those with the Toronto District School Board, the Corporation of the City of Windsor and the Ontario Power Authority.

	(in thousands of dollars)	
	March 31, 2005	***March 31, 2004***
Ontario Lottery and Gaming Corporation	$ 685,490	$ —
Toronto District School Board	55,200	*55,200*
Ontario Northland Transportation Commission	35,440	*51,111*
Corporation of the City of Windsor	23,393	*24,221*
Ontario Power Authority	6,782	—
Centennial Centre of Science and Technology	250	*500*
	$ 806,555	$ *131,032*

The Ontario Lottery and Gaming Corporation (OLGC) is a Crown agency of the Province under the *Ontario Lottery and Gaming Corporation Act, 1999*. Members of the corporation are appointed by the Lieutenant Governor in Council. The OLGC loan of $794 million (outstanding as at March 31, 2005 —$685 million) was issued on June 30, 2004, to purchase the casino complex in Niagara Falls. This is a five-year loan at 4.3821 percent maturing in June 2009.

The Toronto District School Board has been incorporated under the *Education Act* and is existing under the laws of the Province of Ontario. Public school trustees are elected to represent the public school supporters in the City of Toronto. The 10-year debenture of $55.2 million was issued on March 31, 2004, at 3.999 percent. Interest and principal repayments commence in March 2008.

The Ontario Northland Transportation Commission (ONTC) is a Crown agency of the Province under the *Ontario Northland Transportation Commission Act, 1990*. Members of the Commission are appointed by the Lieutenant Governor in Council.

- The ONTC debentures (outstanding as at March 31, 2005—$24.9 million) were issued in three stages: $3.9 million at 5.64 percent, maturing in April 2008; $12.7 million at 6.37 percent, maturing in August 2014; and $19 million at 5.6 percent, maturing in December 2014.
- In addition, the Minister of Finance directed the OFA on March 31, 2004, to assume the Province's lines of credit to ONTC of up to $27 million, which expired on March 31, 2005. The entire amount available of $27 million on the lines of credit were drawn as at March 31, 2005. However, by Order in Council dated March 31, 2005, the ONTC was released from its obligation to repay $20.3 million under the existing credit facilities and approval was received to extend ONTC's operating lines of credit until March 2008 for a maximum of $13 million. As at March 31, 2005, amount drawn on the extended lines of credit was $6.7 million.
- Also, during the year ended March 31, 2005, ONTC received short-term loans totalling $3.8 million at 3.0–3.21 percent. These loans of $3.8 million were subsequently consolidated on January 1, 2005 into a 15-year long-term debenture at 5.22 percent maturing in January 2020.

The Corporation of the City of Windsor is a municipality within the meaning of the *Municipal Act*. The

financing provided is for the acquisition, design and construction of the Windsor Justice Facility, consisting of provincial division courthouse and city police headquarters. This is a 20-year debenture at 6.41 percent maturing in March 2021.

The Ontario Power Authority (OPA), established in December 2004, is not a Crown agency, but rather a not-for-profit corporation. OPA received short-term loans totalling $76.6 million at 2.63–2.65 percent of which $69.8 million was repaid before the end of the year. The balance outstanding as at March 31, 2005, was $6.8 million.

The Centennial Centre of Science and Technology is a Crown agency of the Province under the *Centennial Centre of Science and Technology Act*. Its Board of Trustees is appointed by the Lieutenant Governor in Council. Under the loan agreement, rate of interest on the principal outstanding (not to exceed $1.0 million) is OFA's lending rate, reset and payable monthly. The interest rate as at March 31, 2005, was 2.72 percent (March 31, 2004—2.28 percent). The borrower agrees to repay one quarter of the aggregate principal sum at the end of each fiscal year with the final principal repayment on March 31, 2006.

(ii) Investing for Related Parties: In the normal course of operations, the OFA provides investment management services to other public bodies as listed below. Funds managed on behalf of other public bodies, as at March 31, 2005 (which are not reflected in these financial statements), are as follows:

(in thousands of dollars)

	March 31, 2005	***March 31, 2004***
Ontario Strategic Infrastructure Financing Authority	$ 1,916,823	*$ 1,302,976*
Northern Ontario Heritage Fund Corporation	187,317	*183,217*
Ontario Realty Corporation	132,291	*111,498*
Ontario Immigration Investor Corporation	185,895	*62,330*
Ontario Trillium Foundation	103,267	*99,737*
Ontario Securities Commission	31,997	*31,996*
Algonquin Forestry Authority	2,560	*1,852*
	$ 2,560,150	***$ 1,793,606***

The OFA also manages debt and investment on behalf of the Province, including the joint management of funds owned by Ontario Power Generation Inc. (OPG) under the Ontario Nuclear Funds Agreement (ONFA). The Province, OPG and certain OPG subsidiaries entered into the agreement in March 2002 to dispose of nuclear waste and used fuel and to decommission nuclear power stations. The agreement came into force during 2003–04.

Cost recovery from the Province for all debt management and investment activities for the year ended March 31, 2005, was $15 million (March 31, 2004—$13.4 million).

(iii) Due from Agencies

a) **Ontario Electricity Financial Corporation (OEFC):** The OEFC is the agency responsible for servicing and retiring the debt and certain other liabilities of the former Ontario Hydro. The OFA provides financial services and advice to OEFC and manages its debt portfolio estimated at $27.6 billion as at March 31, 2005 (March 31, 2004—$27.6 billion) on a fee-for-service basis.

b) **Ontario Strategic Infrastructure Financing Authority (OSIFA)—formerly OMEIFA:** OSIFA was established as a Crown agency under the *Ontario Municipal Economic Infrastructure Financing Act, 2002*. As per 2004 Budget, OSIFA's mandate is to provide affordable infrastructure renewal loans to meet municipal, health, education, post-secondary and housing priorities. In the 2005 Budget, OSIFA's loan program was broadened so that loans also will be available to municipalities for investments in local culture, tourism and recreation infrastructure projects.

The OFA manages the debt of OSIFA, which includes loans from the Province of Ontario of $1 billion, loans from Ontario Clean Water Agency of $120 million, Ontario Opportunity Bonds of $323 million, Infrastructure Renewal Bonds of $650 million and Commercial Paper of $314 million as at March 31, 2005, and provides investment, cash and related financial management services on a fee-for-service basis.

Total costs incurred on behalf of OEFC and OSIFA are netted against OFA costs and are not reflected in the statement of net income. These costs and the total receivable from these agencies as at March 31, 2005, are as follows:

(in thousands of dollars)

	Costs incurred March 31, 2005	Balance outstanding March 31, 2005	*Balance outstanding March 31, 2004*
OEFC	$ 2,207	$ 558	*$ 695*
OSIFA	1,078	247	*445*
Total	**$ 3,285**	**$ 805**	***$ 1,140***

5. FUTURE EMPLOYEE BENEFITS

The OFA provides pension benefits to its full-time employees through participation in the Public Service Pension Plan, which is a multi-employer defined benefit plan. This plan was accounted for as a defined contribution plan, as the OFA had insufficient information to apply defined benefit plan accounting to this pension plan. The cost of the pension plan is paid by Management Board Secretariat and is not reported in the financial statements. In addition, the cost of post-retirement, non-pension employee benefits is paid by Management Board Secretariat and is not reported in the financial statements.

6. FINANCIAL INSTRUMENTS

The carrying amounts for cash, accounts receivable, loans receivable, and accounts payable and accrued liabilities approximate their fair values because of the short-term maturity of these instruments.

Given that the terms and amounts of the OFA's long-term receivables offset the OFA's long-term debt, providing fair values for these instruments would not add any more useful information to that which has already been presented in these financial statements.

7. CONTINGENCIES AND COMMITMENTS

The OFA, in the ordinary course and conduct of its business, may be exposed to various legal proceedings. At March 31, 2005, the OFA was not aware of any material or actual legal proceedings against the OFA, except for those arising from the operation of the POSO until the date of its sale on March 31, 2003. Such contingencies would include civil litigation and grievance proceedings. There are no material claims outstanding. Settlements, if any, relating to POSO, concerning these contingencies, will be accounted for by the Province in the period in which the settlement occurs. The outcome and ultimate disposition of these actions are not determinable at this time.

8. COMPARATIVE FIGURES

Certain of the 2003–04 comparative figures have been reclassified to conform with the financial statement presentation adopted in 2004–05.

9. SALARY DISCLOSURE

The *Public Sector Salary Disclosure Act, 1996* requires disclosure of Ontario Public Sector employees paid remuneration (e.g., salary, performance-based pay and severance) during the year in excess of $100,000. The amounts paid to such individuals in calendar 2004 are listed below:

Name	Position	Remuneration Paid	Taxable Benefits
Charles Allain	Director (A), Debt Management	$ 178,154	$ 240
Ken Broadbent	Manager, Foreign Exchange	$ 124,813	$ 175
Joseph Campos	Director, Risk Control	$ 151,573	$ 234
Edmundo Castellanes	Manager, Risk Control Operations	$ 106,412	$ 164
Robert Coke	Director, Strategic & Operations Research	$ 106,317	$ 187
Donna Crux	Manager, Account Management	$ 101,426	$ 173
James Devine	Manager, Medium-Term Notes & Private Placements	$ 152,752	$ 214
Bryan Everitt	Manager, IT Bus. Sol. & Oper. Support	$ 107,685	$ 188
Susan Guinn	Director, Retail Markets	$ 113,432	$ 195
Andrew Hainsworth	Manager, Funding	$ 143,805	$ 197
Douglas Harrington	Manager, Risk Control Financial Engineering	$ 131,161	$ 214
Serge Imbrogno	Director, Electricity Finance	$ 108,327	$ 188
John Logie	Manager, Financial Engineering	$ 123,224	$ 173
Michael Manning	Executive Director (A), Capital Markets	$ 224,798	$ 299
Gadi Mayman	Vice-Chair & CEO, OFA (interim)	$ 294,363	$ 428
John McKendrick	Director, Corporate Finance	$ 100,538	$ 175
Christine Moszynski	Director, Capital Markets Treasury	$ 130,495	$ 211
Dermot Muir	Legal Counsel	$ 157,053	$ —
David Peters	Manager, Debt Management	$ 151,247	$ 214
Ken Russell	Legal Counsel	$ 161,806	$ 276
Karen Sadlier-Brown	ADM, Corporate & Electricity Finance	$ 142,012	$ 249
Corey Simpson	Director, Legal Services	$ 180,705	$ 291
Linda Smith	Manager, Electricity and Nuclear Fund	$ 113,991	$ 164
Jeffery Telford	Manager, IT Infrastructure Management	$ 103,864	$ 177

Corporate Governance

Financial Reporting

Board of Directors

Corporate Governance

Corporate governance at the OFA involves processes that permit the effective supervision and management of the OFA's activities by its senior management staff, its Board of Directors and the Minister of Finance. It includes identifying those individuals and groups who are responsible for the OFA's activities and specifying their roles. The OFA's governance framework is fully described in the OFA's corporate governance policy, which is reviewed annually by the Board of Directors.

Accountability

The OFA's accountability structure flows from its governing statute, the *Capital Investment Plan Act, 1993* and from a Memorandum of Understanding between the OFA and the Minister of Finance, as well as from directives issued by Management Board of Cabinet (MBC) relating to Crown agencies. Together, these provide that the Minister of Finance is accountable to Cabinet for the activities of the OFA. In turn, the Chair of the OFA Board of Directors is accountable to the Minister for the performance of the OFA in fulfilling its mandate. The OFA Board of Directors is appointed by the Lieutenant Governor in Council and is accountable to the Minister of Finance, through the Chair, for supervising the management of the OFA's business affairs. The Chief Executive Officer (CEO) is accountable to the Chair of the OFA Board for the day-to-day management of the OFA's operations and the management and supervisions of OFA staff. OFA staff are appointed pursuant to the *Public Service Act* and are subject to MBC policies and directives applicable to public servants. OFA staff are accountable, through OFA senior management, to the CEO.

Roles and Responsibilities

The Minister maintains communications with the OFA regarding government policies, expectations and new directions for the OFA. The Minister is responsible for reviewing and approving the OFA's annual business plan and for recommending the plan for approval to MBC every three years or as otherwise required by government directives.

The Chair, who is also the Deputy Minister of Finance, provides leadership and direction to the CEO and the OFA Board and ensures the OFA's compliance with government policies and directives. The CEO is responsible for the ongoing activities of the OFA and ensures that policies and procedures, including financial reporting, remain relevant and effective.

The Board of Directors meets at least quarterly and receives regular reports from the CEO and other OFA staff concerning the operations of the OFA and its compliance with applicable laws and policies. The Audit Committee of the OFA Board approves an annual internal audit plan for the OFA and liaises with the internal auditors (Audit Services Division of Management Board of Cabinet) and the Auditor General regarding the OFA's financial reporting and controls. It also reviews and recommends financial policies and the OFA's financial statements to the Board. Standards of conduct for Board members are set out in a Board-approved code of conduct.

Financial Reporting

The OFA prepares annual financial statements in accordance with Generally Accepted Accounting Principles (GAAP) for approval by the Audit Committee and the Board of Directors. Unaudited financial statements are prepared quarterly and presented to the Audit Committee and the Board. The annual financial statements are reviewed by the Provincial Auditor who expresses an opinion on whether they are presented fairly and in accordance with GAAP. The findings are reviewed by the Audit Committee and the Board of Directors. These audited financial statements are tabled in the Ontario Legislature as part of the OFA's Annual Report and are included as a schedule to the Public Accounts of the Province.

Board of Directors

The following individuals were members of the Ontario Financing Authority's Board of Directors in 2004–05:

Colin Andersen, Chair of the Ontario Financing Authority and Deputy Minister of Finance. Appointed to the OFA Board of Directors February 2004. His appointment expires when a successor is appointed.

Colin was formerly Deputy Minister, Policy, Cabinet Office. He also has served as the Associate Deputy Minister, Ministry of Health and Long-Term Care, the Assistant Deputy Minister, Integrated Policy and Planning, Ministry of Health and Long-Term Care and Assistant Deputy Minister, Fiscal and Financial Policy, Ministry of Finance. He has held a number of senior management positions in the Ministry of Finance and Cabinet Office. Colin has a BA in Economics (Honours) from the University of Calgary and an MA in Economics from the University of Toronto.

Gadi Mayman, Chief Executive Officer and Vice-Chair (interim) of the Ontario Financing Authority. Appointed to the OFA Board of Directors from August 2000 to June 2002 and November 2003 to October 2005.

Gadi also is Chief Executive Officer and Vice-Chair (interim) of Ontario Electricity Financial Corporation (OEFC), interim Vice-Chair of the Ontario Strategic Infrastructure Financing Authority (OSIFA) and a director of the Ontario Clean Water Agency (OCWA).

Prior to joining the Ontario Ministry of Finance in 1991, he was a Treasury Officer at the Export Development Corporation in Ottawa for three years and in the International Division of the Toronto Dominion Bank. Gadi received a B.A. Sc. in Industrial Engineering from the University of Toronto in 1981 and an M.B.A. from the University of Western Ontario in 1988.

Frank Potter, Chairman of Emerging Markets Advisors Inc., Toronto. Appointed to the OFA Board of Directors from May 2000 to June 2006.

Frank sits on a number of boards, both corporate and not-for-profit. He was a former advisor to the Department of Finance (Canada), and prior to that was Executive Director of The World Bank in Washington, D.C. He also has held a number of senior positions in international banking in North America, Europe and Asia.

Carol Layton, Deputy Minister of Results Delivery (Cabinet Office). Appointed to the OFA Board of Directors from July 2003 to July 2006.

Prior to this appointment, Carol was the Deputy Minister of Citizenship and Immigration as well as Deputy Minister Responsible for Women's Issues and Seniors. She has held various positions in the Management Board Secretariat, the ministries of Health and Long-term Care, Finance, Attorney General and Treasury and Economics. Carol holds a Bachelor of Environmental Studies (Honours) degree from the University of Waterloo.

Tye W. Burt, President, CEO and Director, Kinross Gold Corporation. Appointed to the OFA Board of Directors from June 2000 to July 2006.

Prior to this position, Tye was Vice-Chairman and Executive Director, Corporate Development with Barrick Gold Corporation. He is a Director of NRX Global Corporation, a network platform provider and portal for the global heavy equipment and parts industry. He is former Chairman of Deutsche Bank Canada and Deutsche Bank Alex.Brown Securities Canada. Before joining Deutsche Bank, he spent over a decade at Nesbitt Burns Inc. and Burns Fry Ltd. Tye is also a Member of the Law Society of Upper Canada.

Tye received his law degree from Osgoode Hall Law School in 1983 and a B.A. (Honours) from the University of Guelph in 1980.

Jack M. Mintz, is President and Chief Executive Officer, C.D. Howe Institute. Appointed to the OFA Board of Directors from September 2003 to September 2005.

Jack also serves on various corporate and not-for-profit boards. He has published more than 180 books and articles in the fields of public economics and fiscal federalism. He serves on the Board of Governors of the National Tax Association in Washington, D.C., is an Associate Editor of Contemporary Accounting Research and International Tax and Public Finance and is a research fellow of CESifo, Munich, Germany. He is also Deloitte and Touche LLP Professor of Taxation, Joseph L. Rotman School of Management, and co-director of the International Tax Program, Institute of International Business, both at the University of Toronto.

Jack has served as a visiting economist at the Department of Finance, Ottawa, and Chair of the federal government's Technical Committee on Business Taxation in 1996 and 1997; Associate Dean (Academic) of the Faculty of Management, University of Toronto, 1993–95; a special advisor to the Deputy Minister, Tax Policy Branch, Department of Finance, Ottawa, 1984–86; and Director of the John Deutsch Institute, Queen's University, 1987–89.

Risk Management Policies and Procedures

Risk Management Policies and Procedures

OFA risk management policies and procedures provide for the management of risk exposures created by capital market activities. Current policies and procedures address market, credit and operational risk exposure as they pertain to the Province's debt and derivatives portfolios and capital markets transactions.

The policies were developed following the guidelines and directives of regulatory bodies, such as the Office of the Superintendent of Financial Institutions of Canada, the Bank for International Settlements (BIS) and in consultation with Canadian bank representatives on their risk management practices.

The OFA's Board and management committees establish and approve risk management policies and monitor the performance of the OFA's capital market activities.

Market Risk Policy

Market Risk is the risk of financial loss attributable to changes in interest rates, foreign exchange rates and market liquidity. This policy provides a framework for borrowing activities and integrates several aspects dealing with the management of market risk. The policy includes several limits:

- Foreign Exchange Limit–the Province's unhedged foreign currency exposure is limited to 5 percent of outstanding debt. Foreign exchange exposures are limited to Group of Seven currencies or the equivalent currencies (e.g., the Euro) and the Swiss franc.
- Interest Rate Resetting Limit–The Province's interest rate resetting risk exposure is the sum of maturities and floating-rate debt with interest resets over the next 12 months and is limited to a maximum of 25 percent of outstanding debt.
- Debt Cost Loss Limit–The total amount of financial losses resulting from market risk and the default of counterparties shall not exceed a debt cost loss limit of three percent of Interest on Debt. In addition, the CEO establishes a trigger level to ensure that market and credit losses will not reach the debt cost loss limit. The trigger level is included in the annual financing, debt and electricity management plan.

The OFA identifies and quantifies exposures to market risk in its annual financing and debt management plan to ensure that risk exposures and losses remain within the approved exposure and loss limits. Exposure to market, credit and liquidity risk is measured daily.

When issuing new debt on behalf of the Province, the OFA will aim for a smooth debt maturity profile to diversify the interest rate risk for the refinancing of maturing and floating rate debt.

Credit Risk

Credit risk is risk in which a counterparty does not meet, or defaults on, its obligations. Credit risk arises when the OFA undertakes financial and derivative transactions. The minimum credit rating of a counterparty for a new swap transaction is typically AA minus and R1-mid for money market investments. The resulting exposure is capped at mark-to-market limits depending on the counterparty's credit rating and capital base.

Policy on the Use of Derivatives

Derivatives are used to manage exposures arising from existing and planned debt issues in a sound and cost-effective manner consistent with the annual financing, debt and electricity management plan. Risks arising from the use of derivatives are identified, monitored, evaluated and managed prudently.

Policy on Risk Management Reporting

At its regular quarterly meetings, the OFA Board of Directors is kept informed of the OFA's activities:

- The CEO of the OFA provides the OFA Board of Directors with a progress report on the implementation of the annual financing, debt and electricity management plan, staffing and other administrative and operational matters. The CEO also reports on the OFA's compliance with applicable government directives and the OFA Legal Director reports on the OFA's compliance with applicable laws; and
- The Director of Risk Control reports on program exposures and performance as well as exceptions to policies.

In addition, OFA management is kept informed of OFA's risk exposures and positions on a daily basis.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems or external events. Each division at the OFA manages operational risk through reviews and improvements of work processes, documented policies and procedures, data processing systems, contingency plans and staff training.

The OFA maintains a Business Continuity Plan (which covers OEFC's operations) which is regularly updated to facilitate the continuation of essential operational functions with a minimum of disruption in the event of an emergency.

Appendix

Ontario's Credit Ratings

Additional Sources of Information

Ontario's Credit Ratings

A credit rating is a current assessment of the creditworthiness of a borrower with respect to a specified obligation. It indicates the capacity and willingness of a borrower to pay interest and principal in a timely manner.

Long-Term Ratings

Long-term ratings are assigned a letter grade ranging from investment grade, to speculative grade, to highly speculative or default. Ratings within each category may include a "plus" or "minus" (or a high or low) to indicate the relative strength of rating within that category. The current long-term ratings of the Province of Ontario are as follows:

- Standard & Poor's Corporation (New York) AA
- Moody's Investors Service (New York) Aa2
- Dominion Bond Rating Service (Toronto) AA

Short-Term Ratings

Short-term ratings are for debt maturities of less than one year. Ratings are graded into several categories, ranging from the highest-quality obligations to default. The current short-term ratings of the Province of Ontario are as follows:

- Standard & Poor's Corporation (New York) A-1+
- Moody's Investors Service (New York) P-1
- Dominion Bond Rating Service (Toronto) R-1 (mid)

Additional Sources of Information

www.ofina.on.ca

Provides information on Ontario's borrowing program and debt, and contains publications from the Ontario Financing Authority and Ontario Ministry of Finance.

Ontario Budget

Paper D, Report on Borrowing and Debt Management, provides a discussion of the Province's borrowing and debt management activities for the fiscal year ended and reviews the outlook for the upcoming fiscal year.

Ontario Economic Outlook and Fiscal Review

The *Ontario Economic Outlook and Fiscal Review* provides a semi-annual update on the Province's economic outlook, fiscal and borrowing plan.

Form 18-k

The Province's annual report to the U.S. Securities and Exchange Commission.

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